



## Adwords payment by Google India to its Ireland counterpart is liable to tax in India as royalty

### Background

- ❖ Google India Private Limited (“Google India” or “assessee”), is the wholly subsidiary of Google International LLC, US. Google India is appointed as a non-exclusive authorized distributor of Adwords programs to the advertisers in India by Google Ireland Ltd. (‘GIL’). Under the Google Adwords Program Distribution agreement dated 12/12/2005, the assessee was granted the marketing and distribution rights of Adwords program to the advertisers in India.
- ❖ During the relevant AY 2008-09, the assessee had credited a sum of Rs.119 crores to the account of GIL without deduction of tax at source. Further, GIL had also not obtained a NIL deduction certificate on the sums payable to it from the Department. Similar are the facts for the other assessment years also. Accordingly, disallowance was made for AYs 2007-08 to 2012-13 on payment of the distribution fees by the assessee to GIL.
- ❖ Tax authorities treated the amount as royalty under the Act as well as under the India-Ireland DTAA. According it was held that the 'distribution rights' are 'Intellectual Property rights' covered by 'similar property' [under the ambit of royalty definition under Explanation 2 to Sec. 9(1)(vi)] and the distribution fee payable is in relation to transfer of distribution rights. Aggrieved, the assessee filed an appeal before Bangalore ITAT.

### Contentions of the assessee

- ❖ Assessee contended that no rights in the intellectual property of the Google were transferred to the assessee from GIL. And it was mere reseller of advertising space made available under the Adword distribution program by GIL.
- ❖ Assessee is a distributor of advertising space and it did not have any access or control over the infrastructure or the process that are involved in running the Adword program, as program runs on software, Algorithm, data center which are owned by Google and its subsidies outside India.

- ❖ The Adword platform is running on servers located outside India that belonged to or hired by Google and the assessee in India has no control over the server of Google.
- ❖ Google does not sell any software but resells products and services which are developed by Google incorporation USA and its subsidiaries outside India.
- ❖ Neither the assessee nor its advertisers get any right or right to use or exploitation over the underlying I.P. or software which is entirely owned by Google incorporation and its subsidies.
- ❖ The assessee placed reliance on Delhi HC rulings in Sheraton International<sup>1</sup> and Formula One World Championship<sup>2</sup> to contend that advertisement services are liable to tax.
- ❖ The assessee also placed reliance on Kolkata ITAT ruling in Right Florist Private Limited<sup>3</sup> and contended that merely displaying or exhibiting of advertisement by the advertiser on the website is not taxable in India.
- ❖ The assessee also relied on Mumbai ITAT ruling in Pinstorm Technologies P. Ltd<sup>4</sup> and Mumbai ITAT ruling in Yahoo India P. Ltd.<sup>5</sup> to contend that the revenue of GIL from Adwords is not taxable in India, since the servers were located outside India.
- ❖ Assessee also challenges the initiation of TDS default proceedings (section 201) beyond 4 years period in view of Special Bench ruling in Mahindra & Mahindra<sup>6</sup>.

## Contentions of the Revenue

Revenue contended that there was use of confidential data by assessee and that amount was being paid by assessee to Google Ireland for the use of patent invention, model, design, secret formula, process, etc., hence the same constituted royalty both under the Act and the DTAA.

## ITAT's ruling

### What rights are granted to the assessee?

- ❖ Referring to the clause of the Distribution agreement, ITAT observes that GIL is allowing the assessee an access to all intellectual property and confidential information which is used for activities related to distribution agreement. This implies that the assessee is having right, title and interest over the intellectual property of Google.
- ❖ The assessee was granted the right to use the valuable business asset of GIL which includes intellectual property in the products and services offered by GIL, for the purpose of marketing and distribution activities
- ❖ Referring to the working of Google Adwords and Google analytics, ITAT observes that *"the assessee is having the access to the I.P. address of the desktop or laptop or I.P. address of the tablet, photographs, time spent on a web site, eating habits wearing preferences etc. With the help of I.P. address, Google search engine is having the access to various information and data pertaining to the user of the website in the form of name, sex, city, state, country, phone number, religion etc. Besides the above basic information, the Google is also having the access of the history of the users as well as to the behavior of the persons searching Google search engine."*

### Simplistic sale of advertisement space or grant of IP rights

- ❖ ITAT distinguished assessee's reliance on Sheraton and Formula 1 judgments, observing that in this case the main service provided was not the advertisement but also providing of any license to use the IPR. ITAT also notes that the use of trademark for advertising marketing and booking in the case of Sheraton as well as in the case of Formula 1 were incidental activities of the assessee therein as the main activities in the cases were providing Hotel Rooms and organizing Car Racing respectively whereas in the present case the main activity of the assessee is to do marketing of advertisement space for Google Adwords Programme.
- ❖ As per the Distribution agreement, the appellant was permitted to use tradename trademarks, service marks, domains or other distinctive brand

<sup>1</sup>[TS-5103-HC-2009(DELHI)-O], <sup>2</sup>[TS-639-HC-2016(DEL)], <sup>3</sup>[TS-137-ITAT-2013(Kol)], <sup>4</sup>[TS-536-ITAT-2012(Mum)]  
<sup>5</sup>[TS-290-ITAT-2011(Mum)], <sup>6</sup>[TS-5212-ITAT-2009(MUMBAI)-O]

features of Google solely for the use under the distribution agreement, hence the payments made by the assessee under the agreement was not only for marking and promoting the Adword programmes but was also for the use of Google brand features.

- ❖ ITAT further distinguished assessee's reliance on Right Florist, observing that the present case is not a case of merely displaying or exhibiting of advertisement by the advertiser on the website, but of use of patented technology, secret process, use of trade mark by the assessee.
- ❖ ITAT also distinguished assessee's reliance on Pinstorm Technologies and Yahoo India, and referring to the detailed working of the Adword programme of the assessee and GIL, ITAT noted that the assessee is having the right to access not only to the IP but also to the customer data and information which was not the case in the aforesaid decisions.
- ❖ ITAT also observes that based on initial key words that the advertiser enters, the tools show various key word suggestions automatically grouped into different ad groups. This is only possible if the assessee permits the use of information, data and key planner to the advertisers which is patent and protected software of the Google.
- ❖ Accordingly, the ITAT concluded that it is not the advertisement or selling of the space rather it is focused targeted marketing for the product/ services of the advertiser by the Assessee/Google with the help of technology for reaching the targeted persons based on the various parameters information etc.
- ❖ Thus ITAT held that the IP of Google vests in the search engine technology, associated software and other features, and hence use of these tools for performing various activities mentioned hereinabove, including accepting advertisements, providing before or after sale services, clearly fall within the ambit of "Royalty".
- ❖ GIL is rendering the services by making available the technology permitted by the Google to the appellant and permitting the same to be used by advertiser, thus it clearly falls within the ambit of 'Royalty' as mentioned in Income Tax Act and under DTAA.

## Interplay of ITES agreement with Distribution agreement

- ❖ Further, it is the prime responsibility of the assessee to give post and prior sales service for resolving the issues of the advertisers, and to ensure due compliances of applicable laws, which are discharged by the assessee through its ITES segment. Also, the inputs from ITES are always required in the business model of the assessee, without which there cannot be any targeted marketing for advertisements and promotion of sales of advertisers. Accordingly, the services rendered under ITES agreement cannot be divorced with the activities undertaken by the assessee under the distribution agreement.
- ❖ ITAT further holds that *"Both the agreements are connected with naval chord with each other. The assessee was duty-bound to provide as per the distribution agreement various ITES services, which the assessee had wrongly claimed to have been provided not under the distribution agreement, but under the service agreement. This is only a design / structure prepared by the assessee to avoid the payment of taxes."*

## Limitation period for initiating 201 proceedings

- ❖ Placing reliance on the recent Allahabad HC ruling in Mass Awash (P.) Ltd.<sup>7</sup>, ITAT held that no period of limitation is provided in the case of non-resident. However, in absence of any direct jurisdictional HC ruling and taking note of various contrary judgements, ITAT held that the period of imitation for initiation of proceedings for resident as well as non-resident u/s 201 should be 6 years from the end of the financial year (which is as per the amended Sec. 201).

## Applicability of section 195

- ❖ ITAT observed that necessary safe-guards are provided by the Act in the form of Sec. 195(2) which clearly provides that in case the assessee is having any doubt about the chargeability to tax of the payment, then the assessee may make an application to the AO for the purpose of determining whether the sum is chargeable to tax or not and if yes, on what proportion. In the present case, no such application was made by the assessee and the assessee on its own, without having knowledge, information and privy to the accounting standard and accounting practice of GIL, has treated the said payment as a business profit of GIL in its books of account.

<sup>7</sup>[TS-289-HC-2017(ALL)]

- ❖ ITAT thus ruled that “whether it is business profit or royalty, in both the circumstances, so far as the assessee is concerned, the assessee is duty-bound to deduct the TDS unless there is an adjudication by the AO to the contrary u/s.195(2).”

#### Chargeability to tax on “receipt” or “accrual” basis]

- ❖ ITAT rejected assessee’s argument that under the provisions of Indo-Ireland DTAA, the royalty is chargeable to tax in the hands of the non-resident on receipt basis. ITAT clarifies that the benefit of DTAA, is only available to non-resident and not to the resident payer. Further, noting that GIL is following the mercantile method of accounting, ITAT holds that the chargeability of tax would be in the year when it is accrued and not in the year when it was received.

#### NANGIA’S TAKE

- ❖ *Recent rulings clearly depict the way our courts have evolved with the evolving global business models, whether it means deeper diving into all the arrangements in place between various group entities OR going behind the arrangements to determine the intent of the parties involved. The courts are not shying away from moving away from the principles laid in earlier rulings.*
- ❖ *In the present case ITAT has dived deeper not only into the Distribution Agreement but also the ITES Agreement (agreement between customers and the assessee) to hold that the assessee was provided access to the IPR, Google Brand features, secret process embedded in Adwords Programme as tool of the trade for generation of income. The ITAT has very finely dwelled into the arrangement to hold that it is not a case of simplistic sale of advertising space, but a targeted marketing using the underlying technology and IP. Hence the payment made by the assessee to GIL constitute royalty and not the business profit and therefore chargeable to tax in India.*
- ❖ *On the argument of chargeability to tax in the hands of non-resident on receipt basis, the ITAT in this case has gone beyond the literal interpretation of the DTAA to hold that,*

- ❖ *the scope and ambit of DTAA as per section 90 of the Act is to grant relief from double taxation, to promote mutual economic relations, trade and investment, for exchange of information for prevention of evasion or avoidance of income-tax chargeable under this Act or in other country, or for recovery of income-tax under this Act or under corresponding laws and not to provide when (i.e. year of accrual or receipt), the income is required to be charged.*
- ❖ *Interestingly ITAT has questioned the intention of the assessee as well as that of GIL. ITAT has stated that in the case on hand, conduct of the two parties, which are associated enterprises (AEs) clearly show that both are trying to misuse the provision of DTAA by structuring the transaction with the intention to avoid payment of taxes.*

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